

manufacture, construction, production, or purchase of such assets is completed.

§ 1.341-3 Presumptions.

(a) Unless shown to the contrary a corporation shall be considered to be a collapsible corporation if at the time of the transactions described in § 1.341-1 the fair market value of the section 341 assets held by it constitutes 50 percent or more of the fair market value of its total assets and the fair market value of the section 341 assets is 120 percent or more of the adjusted basis of such assets. In determining the fair market value of the total assets, cash, obligations which are capital assets in the hands of the corporation, governmental obligations, and stock in any other corporation shall not be taken into consideration. The failure of a corporation to meet the requirements of this paragraph, shall not give rise to the presumption that the corporation was not a collapsible corporation.

(b) The following example will illustrate the application of this section:

Example A corporation, filing its income tax returns on the accrual basis, on July 31, 1955, owned assets with the following fair market values: Cash, \$175,000; note receivable held for investment, \$130,000; stocks of other corporations, \$545,000; rents receivable, \$15,000; and a building constructed by the corporation in 1953 and held thereafter as rental property, \$750,000. The adjusted basis of the building on that date was \$600,000. The only debt outstanding was a \$500,000 mortgage on the building. On July 31, 1955, the corporation liquidated and distributed all of its assets to its shareholders. In computing whether the fair market value of the section 341 assets (only the building) is 50 percent or more of the fair market value of the total assets, the cash, note receivable, and stocks of other corporations are not taken into account in determining the value of the total assets, with the result that the fair market value of the total assets was \$765,000 (\$750,000 (building) plus \$15,000 rents receivable). Therefore, the value of the building is 98 percent of the total assets (\$750,000÷\$765,000). The value of the building is also 125 percent of the adjusted basis of the building (\$750,000÷\$600,000). In view of the above facts, there arises a presumption that the corporation is a collapsible corporation.

§ 1.341-4 Limitations on application of section.

(a) *General.* This section shall apply only to the extent that the recognized gain of a shareholder upon his stock in a collapsible corporation would be considered, but for the provisions of this section, as gain from the sale or exchange of a capital asset held for more than 1 year (6 months for taxable years before 1977; 9 months for taxable years beginning in 1977). Thus, if a taxpayer sells at a gain stock of a collapsible corporation which he had held for six months or less, this section would not, in any event, apply to such gain. Also, if it is determined, under provisions of law other than section 341, that a sale or exchange at a gain of stock of a collapsible corporation which has been held for more than 1 year (6 months for taxable years before 1977; 9 months for taxable years beginning in 1977) results in ordinary income rather than long-term capital gain, then this section (including the limitations contained herein) has no application whatsoever to such gain.

(b) *Stock ownership rules.* (1) This section shall apply in the case of gain realized by a shareholder upon his stock in a collapsible corporation only if the shareholder, at any time after the actual commencement of the manufacture, construction, or production of the property, or at the time of the purchase of the property described in section 341(b)(3) or at any time thereafter, (i) owned, or was considered as owning, more than 5 percent in value of the outstanding stock of the corporation, or (ii) owned stock which was considered as owned at such time by another shareholder who then owned, or was considered as owning, more than 5 percent in value of the outstanding stock of the corporation.

(2) The ownership of stock shall be determined in accordance with the rules prescribed by section 544(a)(1), (2), (3), (5), and (6), except that, in addition to the persons prescribed by section 544(a)(2), the family of an individual shall include the spouses of that individual's brothers and sisters, whether such brothers and sisters are by the whole or the half blood, and the spouses of that individual's lineal descendants.

(3) For the purpose of this limitation, treasury stock shall not be considered as outstanding stock.

(4) It is possible, under this limitation, that a shareholder in a collapsible corporation may have gain upon his stock in that corporation treated differently from the gain of another shareholder in the same collapsible corporation.

(c) *Seventy-percent rule.* (1) This section shall apply to the gain recognized during a taxable year upon the stock in a collapsible corporation only if more than 70 percent of such gain is attributable to the property referred to in section 341(b)(1). If more than 70 percent of such gain is so attributable, then all of such gain is subject to this section, and, if 70 percent or less of such gain is so attributable, then none of such gain is subject to this section.

(2) For the purpose of this limitation, the gain attributable to the property referred to in section 341(b)(1) is the excess of the recognized gain of the shareholder during the taxable year upon his stock in the collapsible corporation over the recognized gain which the shareholder would have if the property had not been manufactured, constructed, produced, or purchased. In the case of gain on a distribution in partial liquidation or a distribution described in section 301(c)(3)(A), the gain attributable to the property shall not be less than an amount which bears the same ratio to the gain on such distribution as the gain which would be attributable to the property if there had been a complete liquidation at the time of such distribution bears to the total gain which would have resulted from such complete liquidation.

(3) Gain may be attributable to the property referred to in section 341(b)(1) even though such gain is represented by an appreciation in the value of property other than that manufactured, constructed, produced, or purchased. Where, for example, a corporation owns a tract of land and the development of one-half of the tract increases the value of the other half, the gain attributable to the developed half of the tract includes the increase in the value of the other half.

(4) The following example will illustrate the application of the 70 percent rule:

Example: On January 2, 1954, A formed the Z Corporation and contributed \$1,000,000 cash in exchange for all of the stock thereof. The Z Corporation invested \$400,000 in one project for the purpose of building and selling residential houses. As of December 31, 1954, the residential houses in this project were all sold, resulting in a profit of \$100,000 (after taxes). Simultaneously with the development of the first project and in connection with a second and separate project the Z Corporation invested \$600,000 in land for the purpose of subdividing such land into lots suitable for sale as home sites and distributing such lots in liquidation before the realization by the corporation of a substantial part of the taxable income to be realized from this second project. As of December 31, 1954, Corporation Z had derived \$60,000 in profits (after taxes) from the sale of some of the lots. On January 2, 1955, the Z Corporation made a distribution in complete liquidation to shareholder A who received:

- (i) \$560,000 in cash and notes, and
- (ii) Lots having a fair market value of \$940,000.

The gain recognized to shareholder A upon the liquidation is \$500,000 (\$1,500,000 minus \$1,000,000). The gain which would have been recognized to A if the second project had not been undertaken is \$100,000 (\$1,100,000 minus \$1,000,000). Therefore, the gain attributable to the second project which is property referred to in section 341(b)(1), is \$400,000 (\$500,000 minus \$100,000). Since this gain (\$400,000) is more than 70 percent of the entire gain (\$500,000) recognized to A on the liquidation, the entire gain so recognized is gain subject to section 341(a).

(d) *Three-year rule.* This section shall not apply to that portion of the gain of a shareholder that is realized more than three years after the actual completion of the manufacture, construction, production, or purchase of the property referred to in section 341(b)(1) to which such portion is attributable. However, if the actual completion of the manufacture, construction, production, or purchase of all of such property occurred more than 3 years before the date on which the gain is realized, this section shall not apply to any part of the gain realized.

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